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Whose Risk, Whose Security?

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THERE'S A NEW DOUBLE STANDARD IN THE GLOBAL ECONOMY. ORDINARY PEOPLE GET LESS SECURITY WHILE ENTREPRENEURS—"RISK-TAKERS"—GET GOVERNMENT GUARANTEES.

WHOSE RISK, WHOSE SECURITY?

BY MARTHA T. MCCLUSKEY

At the opening of the twenty-first century, the United States seems to be leading the world toward embracing risk and rejecting security. Images of risk-taking as the ticket to success saturate contemporary culture, making extreme sports athletes and high-tech entrepreneurs the heroes of the 1990s. Replacing government protections with market challenges has become a central theme in mainstream public policy. The main message of public-policy reforms is that market challenges must replace government guarantees such as Social Security. In the current conventional wisdom, we need the pain, anxiety, and thrills of instability to produce a vigorous society. According to *The Economist*, "It is no coincidence that free-market economies, which encourage personal risk-taking, have outlived centrally planned ones, which do not."

But something is missing from this picture of a trend from risk-taming to risk-taking. The real question raised by recent policy changes is not *how much* risk versus security is good for society, but *whose* risk and *whose* security are good for society. In reality, the recent celebration of risk-taking obscures a double standard through which most ordinary people get reduced security against new market risks, while a small group of global investors get a new system of explicit or implicit government insurance to protect their high-risk gains.

According to the current free market orthodoxy, the policies developed earlier in the twentieth century to control market risks are misguided or backward looking. In response to the Great Depression, New Deal policies minimized market risks for a wide range of people. New Deal social insurance schemes were launched to protect many workers and their families from the risks of income loss from unemployment, old age, and death (and later, disability). New regulatory systems offered investors protection against financial market volatility. The federal government also adopted monetary and fiscal policies designed to soften market cycles with counterbalancing adjustments in interest rates and in government spending and taxing. After World War II, the multinational Bretton Woods agreements established the International Monetary Fund (IMF) to stabilize the international economy by enforcing fixed currency rates. With these policies, the federal government not only assumed risks previously borne by individuals but also adopted regulatory controls that limited risks of speculation and abuse in the financial systems.

But in the 1970s and 1980s, changing economic and political pressures undermined those systems of risk control. Laissez-faire economic theory returned to prominence, promoting "neoliberal" policies that aim to liberate markets from government management. As this ideology gained political muscle, the United States and other nations began lifting some regulatory restraints on banking and other industries, privatizing and limiting government services and social programs, and removing restraints on international trade and investment. In the international economy, floating exchange rates replaced the Bretton Woods system of currency controls. As a result of such free market trends, investors had opportunities to take bigger risks—and to reap correspondingly bigger gains.

WHOSE SOCIAL SECURITY?

However, the much-heralded move away from government protection obscures a simultaneous move toward new forms of government security against private financial risk-taking. For example, the IMF has assumed a new role as crisis manager of

MARTIN COOPER

the global economy. The IMF's function has changed from promoting global economic stability through currency controls to protecting international creditors in a newly volatile global economy. During the early 1990s, private foreign investors flocked to Mexico to earn quick returns of 80 to 100 percent, taking advantage of deregulated financial markets, privatized government industries, and liberalized trade and investment policies. When the Mexican economic bubble burst in 1994, the IMF (led by the United States) protected these high-flying investors from the risk of severe losses with a $50-billion bailout package. Since then, the IMF has handed out billions more in response to economic crises in Indonesia, Thailand, South Korea, Russia, and Brazil.

These IMF rescue packages provide below-market loans that allow governments to maintain debt payments to private international creditors. As a result, this IMF insurance system shifts some of the downside risk of international economic markets from the investors who take the risks and reap the corresponding rewards to the taxpayers of IMF-member countries. In addition, sometimes the IMF has required governments receiving rescue packages to guarantee private debts to foreign creditors, so that taxpayers in "rescued" countries become insurers of foreign investors' risks.

The U.S. government has also provided extensive cushioning against investors' losses from recently enhanced market risk-taking. With the savings and loan industry bailout of the 1980s, U.S. taxpayers insulated bankers, savings and loan managers, and investors against huge losses resulting from high-risk (and high-return) lending in a newly deregulated financial industry. In recent decades, the Federal Reserve has acted as a kind of insurance system for large banks and bondholders, pursuing a monetary policy primarily aimed at protecting bankers and bondholders from the risk of inflation. In 1998 the Federal Reserve also coordinated a private bailout of the Long-Term Capital Management hedge fund out of fear that its catastrophic, highly leveraged losses threatened the stability of major banks and of the international economy as a whole. This deal rescued a group of the richest investors and their large bank lenders, allowing the fund to return to profit levels of 20 percent early in 1999 (after returns of over 40 percent the previous year).

The hedge fund bailout called attention to the new era's double standard of unfettered market risk-taking: The wealthiest investors get greater government security while the majority of society gets greater market risk. Of course, this double standard does not mean international financiers never lose; it just means that their risk of loss is less—and that minimizing their risk is a government priority. In the 1980s, some banks lost money on sovereign loans to Latin America. But the Federal Reserve and the Treasury worked with banks and host countries to arrange debt-equity swaps and other measures to ensure that most lenders were eventually made whole, while the recipient countries suffered a lost decade of growth. Russia's economic collapse in August 1998 left many large investment funds and international banks facing losses of hundreds of millions of dollars. Again, Western governments did not leave banks entirely to the fate of the market. Investors' losses could have been much worse without the government protections aimed at containing the crisis: The Federal Reserve eased interest rates to calm global financial markets, preventing the crisis from spreading, while the IMF began negotiating a new credit package to avoid further debt default. By contrast, the pro-market policies commended to fix Russia's economy have done little to shelter the average Russian, combining higher prices, devalued or nonexistent income, and decimated savings with higher taxes and reduced government spending.

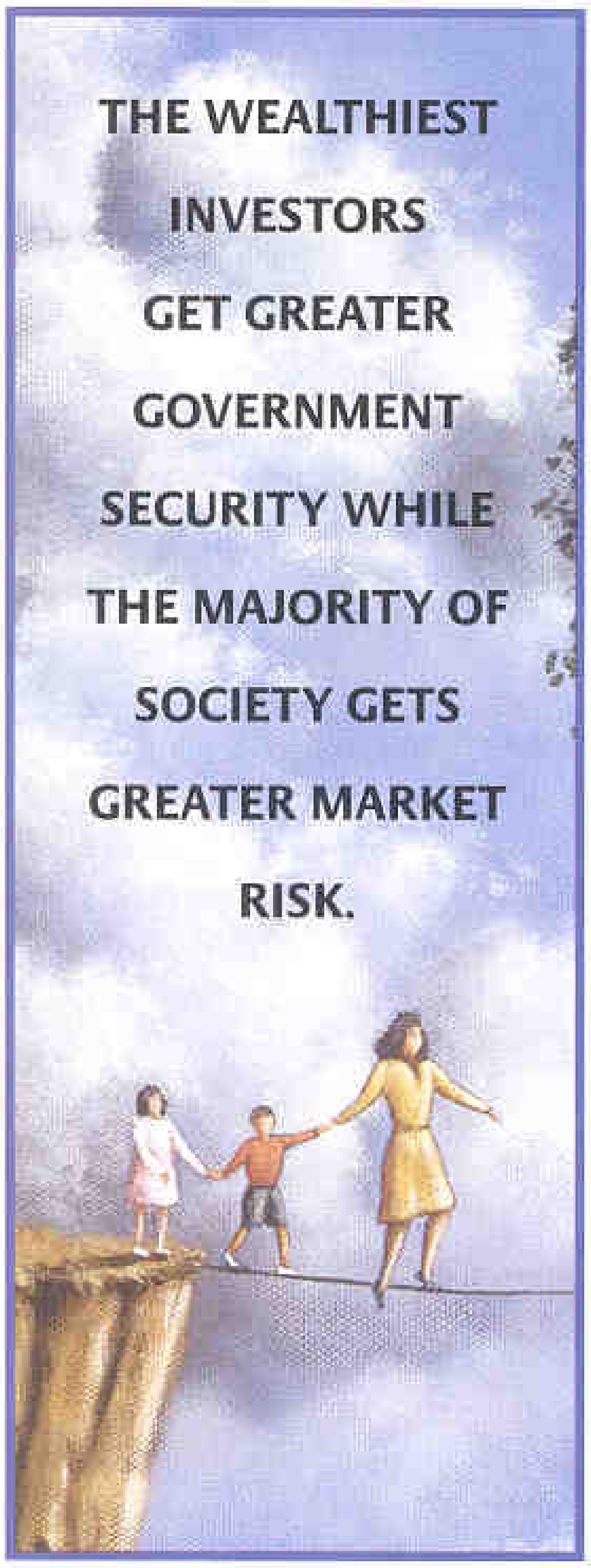
Some libertarian critics argue for correcting the global economy's double standard through expanded risk-taking—eliminating the IMF, for example, or letting hedge funds fail. On the other hand, some concerned centrists and liberals hope to find a "third way" that embraces market risk-taking while preserving some broadly reaching government safety nets. For example, President Clinton has defended Medicare and Social Security along with the IMF and has strengthened some labor protections (the minimum wage) along with protections for global capital (liberalized trade policies).

But the double standard of risk-taking cannot easily be evened out with a bit more security on one side or a bit more risk on the other. Rather, the prevailing ideal of unrestrained markets is fundamentally incompatible with policies to protect the majority of society. One problem is that risk of loss from high-stakes financial speculation is not easily contained in a crisis. By eliminating protections for global finance and just letting the chips fall—increasing risk for those who seek high profits—we would add to the risk for the rest of society. In an interdependent and unstable global economy with concentrated wealth and power, hedge funds and international bankers that fail will take many innocent others down with them.

In addition, free market policies conflict with social protections because the prevailing vision assumes a global market structured to allow elite investors to shift much of their risk of loss to the rest of society. The IMF typically conditions its loans on austerity policies that typically require assisted governments to reduce social spending, to increase interest rates, and to devalue the national currency. That is, the IMF increases stability and security for global investors precisely by shifting economic risks to ordinary citizens, with higher consumer prices (from devalued currency), scaled back social insurance programs, more unemployment, lower wages, deteriorating infrastructure and environmental conditions, and reduced government support of health and education. At the domestic level, the Federal Reserve provides security to investors by *decreasing* security for workers, through monetary policies designed to constrain wage and employment growth.

THE SPECULATIVE PART OF THE ECONOMY IS NOT EASILY CONTAINED IN A CRISIS.

In theory, more safety nets—or fewer bailouts—might somewhat mitigate the effects of this recent redistribution of risk and security. But in practice, recent laissez-faire policies have altered the distribution of political power as well, so that these moderations are less likely. Few global high-rollers are arguing for higher taxes to finance better social insurance. On the contrary, politicians around the world, whatever their ideology, have succumbed to pressures from the IMF and international investors to sacrifice social spending for the sake of better debt servicing, lower corporate and capital taxes, reduced inflation, and stable currency. In the United States, many of President Clinton's original plans to enhance social welfare programs were derailed by threats from the Federal Reserve to raise interest rates and by pressure from financial and corporate interests who provide a major source of campaign financing for elected officials.



WHOSE PERSONAL RESPONSIBILITY?

Free market ideology stresses personal responsibility as a key virtue of market risk-taking. Supposedly, replacing government security with personal risk will benefit society as a whole by preventing what economists call the "moral hazard" of protections that induce careless and wasteful behavior. In this world view, diverting Social Security contributions from government benefits to individual investment accounts will encourage more retirement savings; lowering workers' compensation benefits will encourage workers to work more safely and return to work faster; imposing time limits on welfare benefits will inspire more single parents to work for wages; capping welfare benefits for additional children will discourage impoverished parents from having more babies; and marketizing Medicaid and Medicare will encourage people to be more prudent consumers of medical care.

Nonetheless, when it comes to high finance, the predominant ideology stresses the benefits of *social* responsibility, sounding almost like a New Deal for wealthy investors. According to many ostensible free-marketeers, global competition and capital mobility have created new forms of interdependence that *preclude* personal responsibility for some costly mistakes. For example, in the prevailing wisdom, international financial risks can pose problems of "contagion," so that public protection is necessary to avoid costly damage to society as a whole. Free-marketeers often use this logic of interdependence to justify the powerful new mechanisms of social insurance that protect global capital against the risks of seeking newly liberated market gains.

After the 1998 international economic crisis depleted IMF funds, then–Deputy Treasury Secretary Lawrence Summers explained to Congress that denying the IMF's request for $18 million in additional funding would be like "canceling your life insurance just after you've been diagnosed with a life-threatening disease." In Summers's analogy, IMF bailouts protect U.S. taxpayers because the United States depends on the well-being of the nations and investors aided by the IMF. His analogy suggests that the losses "insured" by the IMF come not from deliberate choices by individual actors (speculative investors) seeking gains but from invisible, unpredictable forces (life-threatening disease) acting upon innocent victims.

New York Times columnist and author Thomas L. Friedman similarly warns of the dangers of rejecting the IMF's safety net for nations at risk of sinking in the global market's rough seas: Without IMF bailouts, he says, we could face international political chaos. He imagines racist rioting and escalating war in Southeast Asia, angry mobs ransacking U.S. corporations in South Korea, and the Russian government auctioning off nuclear technology and uranium to the highest bidder. He even concludes by quipping, "How's that for moral hazard!"

Summers and Friedman deflect concerns about moral hazard from the IMF's insurance scheme by describing it as broad-based protection against unavoidable harm. Taxpayers are not protecting others—foreign nations or global investors—from avoidable risks of greed or mismanagement, in their view. Instead, taxpayers are taking personal responsibility to protect themselves against random misfortune or irrational mobs. Indeed, Friedman argues that *weakening* the IMF's protections would create the real moral hazard problem because the desperate, uncontrolled people of afflicted nations would seek other, more pernicious sources of security. Defenders of recent bailouts of the savings and loan industry and Long-Term Capital Management have similarly dismissed moral hazard concerns with the reasoning that some market players are "too big to fail." Where large financial investors are concerned, personal responsibility is too dangerous because extensive losses in major hedge funds or the savings and loan industry would threaten to spread destruction across the economy like a raging fire.

In short, the prevailing free market ideology assumes that government security protecting elite financial risk-taking is *good* for society because harm to these big risk-takers puts society as a whole at risk. Most of the risk-taking that causes such destruction is presented as inevitable—the product of natural market forces that work to the benefit of all. In Friedman's and Summers's picture of the IMF's security, the only way to lessen the damage of international economic volatility is to get governments and ordinary citizens to help clean up after it.

By contrast, when it comes to ordinary people's exposure to market risks, security becomes a vice, not a virtue. Free-marketeers stress the moral hazard problems of social insurance programs for people who are sick, elderly, unemployed, disabled, or caring for young children; they presume that, unlike multinational corporations or large global investors, ordinary people often have the power and responsibility to prevent harm to themselves and others.

To distinguish "good" from "bad" security, we must make value judgments about what kinds of risks we want to avoid most, and for whom. All government security programs have potential for costly moral hazard; all private risk-taking has the potential for costly "contagion." *Security* against loss always risks hurting society by reducing personal responsibility for avoiding harm to others. But *personal responsibility* for loss always risks hurting society by increasing personal losses likely to spread harm to others. The current IMF policies are misguided not because they promote social protection instead of personal responsibility (as some right-wing critics argue) but because they wrongly protect a narrow group of wealthy investors at the expense of most others.

Free market apologists not only excuse global capital from the problems of moral hazard but also exclude ordinary people from the benefits of security when their suffering gets big enough to risk broader "contagion." Growing economic inequality and heightened job insecurity for the majority of U.S. workers have not sparked generous bailouts in the interests of solidarity and stability. Here, the typical response is punishment, not protection: more restrictions on welfare benefits, along with increased policing, incarceration, and stigma for those who fall through market cracks.

Similarly, at the global level, renewed government control and coercion tends to prevent ordinary market losers from making others share their pain. Vast hordes of humanity have lost savings, jobs, homes, and health in recent market calamities, from the Latin American debt crisis in the 1980s to the recent Asian financial collapse. Yet in many emerging markets, when underpaid workers, hungry citizens, or protesting environmentalists threaten social, political, or economic stability, they are more likely to receive arrest, violence, and political repression than international subsidies. And even where political freedoms are more viable, new global free market institutions like the World Trade Organization are designed to avert "contagion" sparked by popular resistance to austerity plans by moving decisions on economic policy from the national and local political processes to supranational proceedings closed to public participation.

Whose security-seeking behavior should get free reign and whose should get restraint is a question of contested morality and politics—not neutral economics. Prevailing free market ideology dismisses increased risk to society as a small price to pay for the security and freedom of global capital. Inversely, this ideology devalues security and freedom for others as a small price to pay for reducing risk to global capital.

WHAT RISK-TAKING?

The recent romance with risk rests on a muddled standard as well as a double standard; the same behavior may be logically described as either security-seeking or risk-taking or both. Consider a popular slogan used on posters and greeting cards: "The Loftier Your Goals, the Higher Your Risk, the Greater Your Glory." For many, that message of self-assured individualism evokes images of mountain climbers, stock traders, and Silicon Valley entrepreneurs rather than undocumented Mexican immigrants or welfare recipients. But that divergent imagery is less a reflection of differences in the riskiness of the actions involved than of the differences in the social status—influenced by race, class, and gender identity—of the actors.

For example, the border-crossing immigrant who defies heavily armed authority and government regulation in pursuit of personal economic gain could exemplify the virtues of heroic free market risk-taking, in theory. However, in mainstream U.S. politics and culture, this pursuit of global market gain-seeking and entrepreneurial, antibureaucratic nerviness is typically represented as base recklessness, or parasitic evasion of responsibility. As one anti-immigration activist explained, "Hundreds of millions of people have chosen to seek safer havens elsewhere rather than seek indigenous solutions of their society's problems."

Similarly, consider the welfare recipient who refuses to give up her child, get married, or accept low-wage work, and instead aspires to stay on government aid to support her dreams of higher education and motherhood. She is more likely to be condemned for being dependent and insolent than celebrated for setting lofty goals and seeking individual freedom. The dominant free market message to welfare moms is not to hold out for the best job or to pursue glory for self and family—but to be grateful for any job (or for any bill-paying husband). Mothers without well-paying jobs or well-paid husbands tend to be shamed for their supposed irrationality and self-indulgence, not honored for shouldering the hard work of single parenting in high-risk circumstances.

Condemnation of risk-takers in these examples shows that free market ideology vilifies some people for both excessive risk and excessive security. Immigrants and welfare recipients have often been viewed in mainstream media and politics as at once too carefully calculating and too recklessly irrational, too individualistic and too dependent, too ambitious and too cautious.

While some people's risk-taking tends to be condemned as irresponsible government dependence, others' security-seeking tends to respected as productive market risk-taking. Corporate executives and international financiers known for their gutsy market risk-taking often secure lavish personal protection from the costs of their market mistakes. For example, CEO "Chainsaw Al" Dunlap, famous for bold management strategies stressing dramatic employee downsizings, inspired a 49-percent stock jump when he was hired to run Sunbeam Corporation. However, he made sure that his "going for the corporate glory" was accompanied by a no-risk compensation package guaranteeing him $2 million a year for three years regardless of performance (which has been disastrous). Such golden parachutes are conventionally defended as necessary to induce entrepreneurs to take "risks."

More fundamentally, the multinational corporations at the heart of the global free market inherently depend on socialized risk-protection for their success. Limits on liability, which define the corporate form of doing business, act as government insurance through which the risks of capital ownership are spread from the owners to consumers, workers, citizens, and others. This protection, which provides predictability and stability for investors and managers, is widely viewed as encouraging rather than deadening market risk-taking instincts.

By condemning one class of people for being both risk-taking and risk-averse while valorizing another for the same behaviors, free market ideology is not demonstrating a preference for risk over security; rather it's serving to promote those at the top of the economic order as deserving of public support while leaving the many at the bottom to assume greater personal responsibility for their losses.

The problem with the new free market ideology is not that it leads to excessive individual risk-taking or insufficient (or inconsistent) attention to social security; it's that free market policies *redistribute* risk and security. The most consistent message of the free market system is not the embrace of individual risk but the embrace of a vision of community that subordinates the interests of the majority of humanity to the interests of a few. ◆

WILD PITCH

TO THE EDITORS:

Peter Dreier's article on Fenway Park and Boston's current public policy schemes was great ["Wild Pitch," *TAP*, December 20, 1999]. I am a community organizer and resident in the Fenway neighborhood of Boston. Yes, there is a community here—33,000 people including seniors, students, young professionals, and families. For a decade, this community has sponsored efforts to build an urban village center on the same land now talked about for the new Sox park. The plan calls for the development of a mixed-use, mixed-income, resident-oriented neighborhood main street. Relative to the plan for the new park, the costs of the community plan are much lower, not to mention the positive economic impact the new housing and businesses would bring.

JETHRO HEIKO
Via e-mail

RANK CLASS

TO THE EDITORS:

In Peter Schrag's article "Rank Class" [*TAP*, December 6, 1999], Schrag makes several points that I find troublesome. Affirmative action did not raise the issue of ethnicity in a cultural vacuum. Law and practice excluded African Americans from most predominantly white colleges long before affirmative action came along. While Jews had a small quota, the quota for African Americans was zero. Affirmative action was an attempt to address that exclusion.

In addition, Schrag singles out the test score differences between affluent middle-class African Americans and working-class whites. I am not sure what that distinction means since "affluent" and "middle class" are not necessarily synonymous. He fails to mention the test score differences between males and females and between Asians and middle-class whites. I find it interesting that he chose to ignore those disparities while highlighting only those between African Americans and whites.

I am reluctant to attribute sinister motives to people I do not know, but there is a disturbing pattern to Schrag's analysis.

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PETER SCHRAG RESPONDS:

The quota was low but never zero, as the prewar list of distinguished African-American graduates of places like Amherst or Harvard demonstrates. And of course the first remedy for discrimination (and in the minds of most Americans, the best) is color-blind nondiscrimination, which is precisely what the selective institutions first attempted. (For example, by excluding applicants' photographs from admissions applications.) It was only after those attempts failed to attract *enough* candidates that the search began for ways to overcome the perceived educational handicaps of minority applicants. As to the test issue, regardless of how you define economic status, the black-white gap, though closing in the past couple of decades, is there.

BUFFY THE WHO?

TO THE EDITORS:

I'm enjoying *TAP* hugely, but please! For us old fogies who don't watch much TV, who is the female on page 63 in the November 23, 1999, issue? I know it's not Ally McBeal.

RICK WING
Via e-mail

TAP RESPONDS:

The woman is Sarah Michelle Gellar, the actress who plays Buffy Summers in the WB Network's *Buffy the Vampire Slayer.*

CONTRIBUTORS THIS ISSUE

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